

Funding Our Future: Generating State and Local Tax Revenue for Quality Early Care and Education. Boston, MA: The BUILD Initiative.

Funding Our Future: Generating State and Local Tax Revenue for Quality Early Care and Education catalogues the “what” of seven state and local tax areas, providing information about existing foundational efforts and introducing potential “next generation” tax policy ideas for consideration as early childhood leaders consider opportunities to expand and diversify funding quality early care and education. Guiding Questions -- nine strategic and technical questions for early childhood leaders and their partners to consider -- are included prior to the descriptions of the seven tax areas examined to aid early childhood leaders who are new to exploring questions related to tax-based revenue generation to support their early care and education policy. **The questions, listed below, are designed to test the legal, administrative, and political feasibility of these tax policies within state and local contexts.** Without the answers to these questions, it is difficult to know whether a revenue generation policy may be appropriate for your community and may contribute to improved access to high-quality early care and education and, if so, which one. It also should be noted that consideration of these questions will need to be done simultaneously and reflect trade-offs in terms of level of government, taxing options and money raised as part of a holistic process to determine what pathway will be most successful.

Though stakeholders may initially focus on each question individually, selecting a revenue generation mechanism requires holistic consideration. Taken as a whole, these questions may expose tradeoffs that must be made to select an appropriate mechanism, or raise issues about state, regional, and local political contexts and economic climates. The questions, both individually and together, offer a way to frame a narrative around the revenue generation needed to increase funding for quality early care and education.

GUIDING QUESTION 1: WHAT JURISDICTION WILL LEVY THE TAX?

Funding for quality early care and education in the United States comes from taxes collected at the federal, state, and local level. For example, in a city like Portland, Oregon, the federal government improves child care access and quality through the Child Care and Development Fund, the state uses the Oregon Child Care Contribution Tax Credit to improve quality and affordability of child care, and the Portland Children’s Levy uses local property tax to support a broad range of services including early childhood programs. Thus, it is possible to advance tax revenue for quality child care and education at each of these levels though the authority to levy taxes differs. Income taxes are collected and used by the federal, state, and some local governments. Sales tax are applied most commonly at the state level, though many states allow local jurisdictions to establish them as well; taxes on residential, commercial, and industrial properties are routinely employed by local jurisdictions and, to varying degrees, by state government too.

GUIDING QUESTION 2: IS THE TAX LEGALLY FEASIBLE?

It is crucial to assess whether current law permits the tax or if there needs to be a change in law or regulation to enable it to proceed. Authority to levy taxes is dictated by state constitutions as well as state and local legislation. At the local level, the legal authority to levy taxes may be enabled or

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restricted by state law or local legislation. Legislation can also restrict the rate at which taxes may be levied. Because of these complexities, which often require interpretation of state constitutions and local charters, it is critical for early childhood leaders to consult tax experts on the legal feasibility of a mechanism before pursuing it. Leaders may also choose to pursue the passage of legislation that enables additional taxing authority (for example, in a state whose cities do not have the authority to levy commercial real estate taxes, they may wish to pursue state legislation that enables such a city levy). In general, advancing new tax-enabling legislation is more time-intensive and costly than expanding a tax that does not require new legislation. Exceptions to this rule exist, however, particularly when a newly elected policymaker has run on a platform calling for expanded funding for early care and education services, as well as local control. In any case, addressing legal barriers will require time, resources, and strategy, and should be included earlier rather than later in the decision-making process.

GUIDING QUESTION 3: CAN THE TAX BE DEDICATED TO EARLY CARE AND EDUCATION?

When considering the legal authority of a jurisdiction to levy a given tax, early childhood leaders should also determine whether the tax can be dedicated to early care and education. Depending on the jurisdiction and the tax type, it may be possible to dedicate revenue to a fund that is separate and distinct from the jurisdiction's general fund. This prevents revenue from being used for purposes other than those for which it was originally established and, since it is a new and separate budget item, it can also curtail redirection of existing funds with any new funds generated. Dedication of this funding both protects the funding from being used for an alternative purpose and often allows for separate governance for the funding. If kept outside of the general fund, it may be necessary to create an infrastructure for administering the funds, which would be overseen by a new non-profit, a separate governmental department or agency, or a special taxing district. This infrastructure can be composed of stakeholders and experts who understand community need and prioritize quality early care and education, allowing for more effective administration of funding. At the same time, achieving dedication can be difficult and early childhood leaders may ultimately determine that quality early care and education could be sufficiently prioritized to gain from non-dedicated revenue.

GUIDING QUESTION 4: IS THE TAX POLITICALLY FEASIBLE?

Tax proposals are almost guaranteed to face some form of opposition, necessitating careful consideration of the political environment of the state or locality. Opposition could come in multiple forms, so it is important to prepare for a variety of potential arguments against a proposal and to have the ability to negotiate or change course depending on competition from other efforts. Consider the following:

1. How hospitable has your state or community been to raising tax revenues in the past? Take care not to make assumptions here based on party lines; new tax revenue has been generated and dedicated to children in red, blue, and purple areas alike.
2. What tax proposals are most likely to achieve success in the current political climate? Should the decision maker(s) be a legislative body or voters?
3. What partners can you count on as champions of the effort? How will they be involved in and educated about the effort?

4. What is the current appetite of policymakers for generating new revenue? Does a given elected official or policymaker have a desire to make a splash with a bold new initiative, or is he or she in defensive mode?
5. What other major interest groups are currently seeking to generate revenue? Is there potential for a joint effort to pursue different tax strategies?

GUIDING QUESTION 5: IS THE TAX PROGRESSIVE OR REGRESSIVE?

Tax policy experts differentiate between regressive and progressive taxes, terms that refer to the extent to which a tax falls more sharply on people lower on the income scale versus those who are higher up. Regressive taxes are those that lower-income families spend a higher share of their income on the tax, while progressive taxes collect a greater share from those at the top. For example, sales taxes are highly regressive, due to the fact that lower-income families generally spend more of their income on goods that are taxed. This is especially true for cigarette or soda taxes, given lower-income households are more likely to consume these products. In contrast, personal and corporate income taxes are progressive, especially when higher rates are applied to higher levels of income. The harm of a regressive tax on low- and middle-income families can sometimes be mitigated. For instance, although sales taxes are regressive, exempting basic needs (such as groceries) can help blunt some of this effect. The regressivity of the tax may also be mitigated if lawmakers target the resulting revenue to programs and services that particularly benefit families with lower incomes, such as quality early care and education or through targeted tax benefits like a state Earned Income Tax Credit (EITC). If advocates pursue a regressive tax on the promise of mitigating its burden on those with lower incomes, however, it is important to ensure that such mitigation is translated from the theoretical to the practical or the link to programs is maintained and highlighted. For example, exemptions from property taxes for families below a certain income can be automatically calculated rather than requiring these families to know about and submit a complex exemption application. Likewise, renters who might ultimately pay the tax could be included in a property tax abatement included as part of filing state income taxes.

GUIDING QUESTION 6: DOES THE TAX HAVE COMMUNICATION POWER RELATED TO EARLY CARE AND EDUCATION?

Early childhood leaders must be able to make the case that quality early care and education is a high priority for public investment. It is helpful if there is a clear connection between the tax mechanism and early care and education itself. For example, great success has resulted from connecting the dots between sin taxes (on alcohol, tobacco, and marijuana, for example) and mitigating the potential harm to children by using those taxes to fund services such as early care and education programs. There also can be communication power in framing quality early care and education as a means to sustaining a productive workforce and family economic success. In addition, the new arguments emerging about the connection between wealth and early childhood can be explored.

GUIDING QUESTION 7: WHO PAYS FOR THE TAX? WHO BENEFITS FROM THE TAX?

Whether a tax is regressive or progressive only partially determines whether a tax policy is equitable. An additional aspect to consider is whether the tax will have disproportionate racial, economic, or geographical impact. For example, tobacco use disproportionately affects many marginalized populations—including people in low-income communities, people of color, LGBT individuals and those with mental illness. In addition, tobacco industries engage in targeted marketing aimed at

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predominantly black neighborhoods, lower-income consumers, and teenagers. Therefore, expanding tobacco taxes likely worsens some existing inequities, partially undercutting the purpose of the revenue generated.

Another issue is whether the tax can be easily avoided or evaded. People with the ability to evade a tax may do so by using tax experts to find loopholes, which effectively shifts the tax burden to those without the means to avoid the tax. A sales tax can be evaded by shopping in an adjacent community with a lower tax rate.

Tradeoffs must be considered. Early childhood leaders may choose to consider a tax proposal that is relatively regressive if the benefits of the revenue generated to a marginalized population outweigh the burden of the tax on that population, and if the population is in support of the tax.

GUIDING QUESTION 8: IS THE TAX TIMELY?

Early childhood leaders should keep an eye on any changes to state law and their potential for unlocking new sources of revenue. Two such recent changes are the legalization of recreational marijuana and sports betting. Recreational marijuana is now legal in nine states and the District of Columbia, with New Jersey and Pennsylvania considering legalization as well. One of the reasons that state governments have changed laws on marijuana is the potential for public benefits from the sale of recreational marijuana, including job growth and the ability to generate new revenue through sales or business taxes, though the benefit also is often related to mitigating the costs of incarceration. As these policies change, leaders can consider requesting that a portion of the new tax revenue from marijuana sales or sports betting be dedicated to funding quality early care and education as a way to assure all communities benefit. State and local governments may face significant opposition to new taxes. Therefore, a state or local government looking to generate new revenue through a new tax may find it politically expedient to dedicate a portion of or all the revenue to quality early care and education, which polls demonstrate has the power to increase support for tax measures.

GUIDING QUESTION 9: HOW DOES THE PROJECTED GENERATED REVENUE FIT INTO THE NEAR- AND LONG-TERM STRATEGY FOR MEETING THE NEED FOR QUALITY EARLY CARE AND EDUCATION?

No single tax is likely to raise sufficient funding for quality early care and education needs on its own. Achieving comprehensive financing for early care and education means having a near- and long-term plan to put those funding streams in place, including an overall strategic plan. It is important to estimate the capacity of a tax to tackle the gap between current funding and the need, highlighting the need for comprehensive cost modeling as part of the long-term strategy. Likewise, a strategic plan may include community surveys, needs assessments, and fiscal maps that can help identify a targeted area to invest in for maximum impact (e.g., addressing tuition costs for quality early care and education for a specific target population, quality improvement supports, or compensation increases for providers) that are connected to the funding available from new tax revenues.

Another important aspect to consider is how the level of funding could change over time or with economic conditions. For example, the tobacco tax that is the basis of California's First Five early childhood initiative has decreased by 50 percent in the past 20 years. If it is likely a revenue source will decline over time, it is important to pair it with alternative sources to help stabilize funding. In addition, leaders should consider the impact of economic downturns on tax revenues. Some possible taxes vary

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considerably over the business cycle; because the need for care and early education is more constant, tax instruments with more volatile revenues should be combined with other resources or put into a reserve fund from which only a portion are spent each year to help smooth out funding.

It is also important to take stock of whether the effort to increase the tax will build toward a long-term strategy to educate the public and policymakers about the importance of quality early care and education and to produce confidence in the industry. How does the effort build a constituency that supports efforts to fully fund early care and education needs?

Any efforts focused on generating new tax revenue for quality early care and education should document the impact of any funding increase on early care and education quality, availability, and affordability, and to communicate this impact back to the public. The work does not end with the passage of a tax, and is critical to sustaining the public tax investment.